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and
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# Regional Trade and Foreign Currency Regimes Among the Former Soviet Republics*

Renzo Daviddi & Efisio Espa**

**Abstract**

*The paper examines the problems arising from the adoption of national currencies in former Soviet republics, and advances proposals to avoid excessive trade and output contractions. The move towards national currencies in many republics – though politically unavoidable and economically efficient in the medium term – is seen as having disruptive effects on inter-republican trade in the short term, with heavy losses of incomes and employment, which add up to the costs of market transition. Mutual convertibility among the new currencies could allow to overcome some of the negative consequences on trade and production, while in the event of mutual currency inconvertibility the effects on interrepublic trade could be disastrous and only some form of payments agreement could reduce the magnitude of the contraction. An intermediate currency regime which could sustain the level of income and employment would be based on the use of he Russian rouble as a regional means of payment. Such an event, however, would require as a pre-condition the stabilization of the Russian currency.*

*Journal of Economic Literature* Classification Numbers: F15, F31, F36.

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## 1. Introduction

The political dissolution of the Soviet Union has raised a whole series of economic issues which the barely working Commonwealth of Independent States (CIS) seems unable to cope with.[1] The emergence of new states and governments meant the birth of different economic strategies and reform plans, with different timing relative to their implementation. However, in the immediate aftermath of the dissolution of the USSR, all the new independent republics (NIRs) decided to remain part of a common currency area – based on the Soviet rouble. The institutional framework inherited by the previous regime, mostly devoted to the management of a highly centralized economic system, resulted immediately inadequate to cope with the needs of the new "federal" system, with separate (and antagonist) power centres. In particular, at the beginning of 1992 it became very clear that the discipline required to maintain an economic and monetary union, or even more flexible forms of collaboration, would have unavoidably clashed against the uncoordinated nature of the reform efforts in the various republics.

In the course of 1992, exchange of goods and services between the new independent states has been increasingly impeded by new trade barriers – mostly export restrictions – in a context in which what had been considered domestic transactions, planned by a single central authority and involving the use of *one* money, became part of the foreign trade of each republic. Moreover, in the attempt to gain a higher degree of independence from the Russian Federation and to overcome growing shortages of roubles, an increasing number of NIRs issued new currencies or additional means of payments.

Trade relations among republics, however, remained based on the former Soviet industrial structure, characterized *inter alia* by an extremely high concentration of production in a limited number of giant enterprises. This led to the rise of heavy payments imbalances, and to a sharp contraction of interrepublic trade.

Similarly to what happened after the dissolution of the CMEA, all the ingredients for a collapse in economic relations between the new nations are present, with dramatic consequences upon production and income. The interdependence created in decades of central planning cannot be broken so suddenly without incurring unbearable costs.

This paper has two main objectives: to examine the problems arising from the trend towards the adoption of national currencies in the post-

[1] For the purposes of this paper all the 15 republics emerged from the dissolution of the Soviet Union are taken into account.

Soviet states; to analyze and propose possible solutions to avoid excessive trade and output contractions.

In order to do so we start by reconstructing the main mechanisms of income redistribution in the Soviet Union (section 2). Three main channels are identified and discussed: the transfers linked to the Soviet budgetary procedures, the explicit transfers from the Union government to the peripheral regions of the USSR and the implicit transfers through the distorted domestic pricing system. We turn then to analyze the degree of integration of the former Soviet republics. In section 3 we attempt, with the help of some empirical estimates, to define more precisely the degree of economic integration of the republics. As expected, a number of indicators point to the fact that these economies are a set of strongly integrated systems. The potential and actual costs of the disruption of interrepublic trade are assessed in section 4. We show that the sudden shift away from trade with former partners place a heavy burden on the NIRs, which sums up to the costs of the transition. In order to preserve a level of trade compatible with the previous degree of economic integration, multilateral solutions should have been envisaged. Unfortunately, as described in section 5, the NIRs are so far moving in a completely different direction. Not only trade is being increasingly based on bilateral agreements, but we have witnessed the breaking up of the rouble zone, and the creation both *de jure* and *de facto* of separate republican currencies. Costs and benefits deriving from the introduction of national currencies are discussed in section 6, while in section 7 the recent experience of some republics in introducing a new legal tender is described. Solutions to avoid an excessive trade contraction are highlighted in section 8, where three scenarios are described, involving alternative trade and payments agreements among former Soviet republics. A few concluding remarks summarize the main findings of the paper.

## 2. Gainers and losers in Soviet regional policy

One of the claim often made by Soviet policy makers concerned their success in re-equilibrating income distribution at territorial level. Three mechanisms were at work:

***Transfers linked to the Soviet budgetary process.*** The role of the budget in a federal state – as the Soviet Union was considered until its dissolution – is, among other things, that of transferring resources, in accordance with government decisions, to promote the development of particularly backward regions and to provide a more balanced distribution of wealth. Indeed, the Soviet system aimed to respond to the principle of budgetary federalism.

The "USSR State Budget" consolidated both the all-Union and the Union Republics budgets, as well as the budget of the State Social Insurance. The deficits of the republic were financed by the Union, by allowing a greater share of turnover tax to be retained by the Republics or by direct transfers. These rules basically remained unchanged until the dissolution of the USSR, despite attempts at decentralizing some of the decisions and to make local authorities responsible for financing their own expenditure, both at the Republican and local level.

According to Bahry (1987), the retention quota for the turnover tax varied significantly among republics, ranging at the beginning of the 1980s from 100% in Kazakhstan, Kyrgyzstan and Turkmenistan to 48% in Russia and 43% in Latvia. Revenues from turnover tax retention represented over one third of income in Armenia, almost one fourth in the other Asiatic republics, and about one fifth in the Baltic republics.

***Transfers (explicit) from the Union to the peripheral regions of the USSR.*** Direct transfers from the Soviet budget were also a major source of income for the same regions. According to data reported in the study by the EC Commission on the Soviet Union (Commission of the European Communities, 1990, p. 150) unrequited transfers grew steadily from R305 mn in 1975 to R5.9 bn in 1989. The recipient areas have been mostly the five Central Asian republics, with the exception of 1986 and 1987 when a small grant (a total of R278 mn) went to Latvia. Grants represented a massive contribution (about half) to the income of the Central Asian Republics.

***Transfers (implicit) through the pricing system applied to inter-republic relations.*** The bulk of the transfer, however, was based on the price system governing exchanges between republics. As is well known, domestic prices in the USSR were heavily distorted. Trade balancing in domestic prices was not the expression of an "equal" exchange of goods and services among two republics, but simply an accounting device with no real economic meaning. So called "soft goods" (foodstuffs, manufactured, services and part of chemical products) were overpriced, while hard goods (especially raw materials) underpriced with respect to world market prices of comparable products. According to this principle republics producing energy and raw materials were the net losers *vis-à-vis* all the others.

## 3. The former Soviet republics: a set of strongly integrated economic systems

The Soviet economy was characterized by a high level of regional specialization and interrepublic trade. Regional policy in the former USSR aimed at maximizing benefits from economies of scale, and achieving integration between different areas.[2]

As shown in table 1, in 1990 the share of interrepublic trade on GNP[3] – on average 29% – was considerably greater than comparable data for the EC – 13.7%. Data in the table also indicate that inter-republican trade was by far more important than the exchange with the rest of the world. On average trade with other republics accounted for over 86% of total trade in the former Soviet republics, compared, for instance, with less than 60% in the EC. Moreover, for five of the fifteen republics it represented about 90% of the total, while trade with the rest of the world was of some relevance only for the Russian Federation. The data reflect the interdependence of productive processes taking place in the monopolistic environment of different republics, which, because of regional specialization, remained strongly dependent on outside inputs. With the exception of Russia and the Ukraine, regional trade represented about half of the income of each republic.

Intuition suggests a preponderant role for Russia in the commercial relations with the other republics. Available data allows us to verify the percentage of aggregate demand linked in each republic to exports to the Russian Federation.[4] Results from the calculations are reported in table 2. On average in 1990 exports to Russia represented around one quarter of the

[2] For a description of the regional economic policy in the USSR, see Schiffer (1989).

[3] As will be discussed in detail below, given the distorted nature of Soviet domestic prices and the use of arbitrary criteria in the conversion of foreign trade prices (often misleadingly labelled "world prices") into domestic prices, results should be interpreted as rough indicators. This is particularly true for all indices where income (either NMP or GDP) is used, given the necessity to convert import and export vectors valued at foreign trade prices into domestic prices.

[4] A simple indicator can take the form:

$$EXRU = \frac{X_{iR}}{Y_i}$$

where:
$X_{iR}$ = export from the ith-republic to Russia
$Y_i$ = income indicator for the ith-republic

income of the other fourteen republics, and more than 30% for five of them. If we perform a similar exercise for the EC countries, with Germany playing the role of "attractor", we obtain much lower shares (cf. table 3). On average exports to the FRG in 1989 represented less than 4% of the income of the other EC members. They constituted respectively 3.4%, 2.8% and 2.2% of the income of large countries such as France, Italy and the UK. The highest values obtained for EC members, the Netherlands – 14.4% – and Belgium/Luxembourg – 13% – is very close to the lowest value among NIRs, Kazakhstan – 12.8%.

At the same time, non-Russian Republics exports to republics other than the Russian Federation are also an essential component of aggregate demand of each state. On average in 1990 over 60% of each republic's exports was directed outside Russia, thus excluding the possibility that a number of bilateral agreements between Russia and the various republics would be a viable substitute for a multilateral trade structure.

Proposals have been advanced to create preferential trade areas in the territories of some of the republics, e.g. the Baltic or Asiatic republics. The creation of such areas should reflect existing "preferential" trade links among a set of republics, and should indicate a higher (at least higher than NIRs average) degree of integration. Republics that are more integrated should present a high degree of openness towards the (group of) republics making up a possible preferential area.

Available data do not confirm such a hypothesis. The degree of openness of each republic towards the other fourteen has been calculated[5] and results have been ranked in table 4 for the six main trade partners of each republic. The table shows three points very clearly. First, Russia is by far the main trading partner of *all* other republics. With the exception of Tajikistan and Kyrgyzstan, the "degree of dependence" is always above 50%.[6] Two Bal-

[5] Dividing the average trade of exports and imports by Net Material Product we have obtained a 15*15 matrix, in which each element $a_{ij}$ represents the degree of openness of republic i towards republic j. The exercise has been performed using trade vectors at domestic prices, for comparability with income data. Alternative calculation based on trade flows valued at world market prices made the dependence on Russian market even worst for the other republics. Calculations performed excluding fuels re-equilibrate somewhat the picture, but did not alter the ranking.

[6] The term "dependence" may sound controversial here. Obviously there is not a one-to-one correspondence between high trade shares and the vulnerability of an economy to external forces. A proper indicator of dependence should take into account the sensitivity of a country's current performance and future development with respect to international trade, i.e., assess the flexibility, the capacity to operate substitution of an economic system. All those elements, particularly relevant in presence of a regime change like the one observed in the NIRs, are missing in a static analysis like the one

tic republics – Estonia and Lithuania – emerged as those with the highest degree of dependence on Russia, respectively 85% and 80%. Second, the Ukraine, and to a lesser extent Belarus, are the second main partners of the remaining republics, although the degree of dependence is much lower than in the case of the Russian Federation. Third, geographical proximity, often referred to as a main determinant of international trade does not seem to play a significant role in the case of NIRs. Data do not indicate neighbourhood as having a significant impact on the degree of interdependence.

In conclusion, the evidence reviewed above suggests a very high degree of integration among former Soviet republics, integration which, however, does not bear any relationship with comparative advantages of the individual republics. The specialization pattern of observed interrepublic trade is the outcome of centralized decision-making, which corresponded to planning priorities, reflected decisions about the location of plants and failed to produce high levels of efficiency. On the one hand, the industrial structure inherited from central planning created an economic interdependence between republics which persisted after the erosion of central planning itself in the second half of the 1980s and which in the short term is going, at least partially, to survive even the rapid disintegration of the Union. On the other hand, the pattern of inter-republican trade observed under central planning is changing as a consequence of the dissolution of the USSR as an unitary state. A decrease in the degree of specialization, and a dramatic change in the division of labour among republics – unavoidably linked to the process of disintegration – is one of the main causes of trade decline. Moreover, the need to proceed towards a profound restructuring and modernization of productive capacity will increase demand for advanced technology and thus will reinforce trade links with developed countries, more than perpetuating the exchange of low quality products among former partners.[7] Nevertheless, if minimizing the overall costs of transition is considered a policy priority, an abrupt reduction of interrepublic trade must be avoided in the short run, however irrational past trade flows were.

presented here.

[7] Future trade pattern will depend crucially on assumptions about import elasticities with respect to prices. Import and export elasticities are a crucial element in forecasting future trade performance in the transition to a new market environment. It has been suggested that for formerly planned economies significant response to price variations (or in its absence devaluation) will not improve the balance of payments, but only worsen terms of trade. On this issue cf. Nuti (1991) and the observations by Williamson in the same volume on the small country case.

## 4. Potential and actual costs of the disruption of inter-republican trade

As a result of the process of price liberalization, and with the intention to exert leverage on the other republics, the government of the Russian Federation has increasingly threatened an unilateral switch to world market prices and hard currency payments in interrepublic trade. Such a move, if effectively implemented[8], would have a dramatic impact on a system of regional trade.

The potential costs of trade collapse in the NIRs have been estimated by Nuti and Pisani-Ferry (1992, p. 13 and table 4 therein). Assuming that hard goods can be sold abroad, the costs of trade collapse for each republic would then depend on its exports of soft goods which could not be sold on other markets.[9] Results indicate very clearly that costs are relatively small for the Russian Federation and Kazakhstan, substantial for the Ukraine and huge – around 50% of each republic's income – for all other republics.

Similar conclusions are reached by Senik-Leygonie and Hughes (1992, p. 372), who suggest that a move to world market prices will cause large changes in terms of trade. While relative trade prices for the entire Union with the rest of the world could grow by as much as 50%, removing the enormous distortions which characterized interrepublic trade, especially increasing to world market level the price of energy and raw materials, would hurt all republics except Russia, Khazakhstan and the Ukraine. The authors conclude that because interrepublic trade is generally two to three times the size of foreign trade for the non-Russian republics, the shift means an overall deterioration in relative trade prices with the exception of Kahzakhstan, the Ukraine and Russia, which, however, will be the overwhelming beneficiary from the dissolution of the Soviet Union.

Indeed, the sudden and drastic curtailment of trade relations is already having negative effects that sums up to the recession provoked by the breaking up of the administrative system and by the harsh adjustment measures adopted in some countries of the region. The dramatic fall in export demand can also be seen as a major element depressing economic activity, although

[8] With effect from 1 January 1993, the Russian government has decided to sell oil and gas at world prices to the members of the Commonwealth of Independent States, Georgia, and the Baltic nations. World prices will, however, be paid only by those republics of the former Soviet Union with which Russia does not have inter-governmental agreements establishing special prices. RFE/RL, *Daily Report*, 14.1.1993.

[9] The authors consider soft goods finished manufactures, services, 50% of chemicals and 50% of food products. They maintain that figures obtained should be considered upper bounds.

estimating the impact of the collapse of trade on output for individual countries is quite difficult. The lack of detailed data so far prevent a proper assessment of the impact of the collapse of interrepublic trade on output in 1992. Results of calculation based on input/output tables for 1987 (Senik-Leygonie and Hughes, 1992, pp. 373-376) indicate that a reduction of 50% in both exports and imports with all the other republics, will account for a fall of national income ranging from 25% (Russia) to 42% (Turkmenistan).

Preliminary results for 1992 point to a reduction of Russian trade with the former Soviet trading bloc higher than 40% with respect to the previous year.[10] If the Senik-Leygonie and Hughes estimates are correct a great portion of income decline observed in the region in 1992 can be re-conducted to the trade collapse.

It has been argued that there are no economic considerations providing a justification for keeping the former USSR members in an economic and monetary union: the more developed republics would probably gain from leaving the union. For instance, Gros (1991, pp. 207ff) maintains that "these republics would want to liberalize their economies faster, they would have a stable currency and they can expect to trade more with the outside world than with the rest of the Soviet Union once their economies are liberalized". Even the possibility of recreating a customs union (or less binding forms of integration) between republics is dismissed under the assumption that it is not likely to yield economic benefits, and might actually be welfare-reducing because it leads to more trade diversion than trade creation.

However, the issue here at stake is not the creation or even the preservation of an existing economic and monetary union. Nor is even the issue of the maintenance of a rouble zone. Recent events, as well as theoretical considerations – both discussed at length below – are ruling out such possibilities. The question to be addressed is whether, in the short-run, the costs of the transition should be unnecessary increased by abruptly disregarding the existing trade links. The example of the former CMEA is indeed illuminating in this respect. Between 1989 and 1991 Soviet export to the CMEA declined on average by 17% p.a., imports by 11% p.a.. The direct effects of the collapse of exports in Central and East European countries may account for one half to three quarters of the their total output decline in 1990 and 1991 (Daviddi, 1992, pp. 273-276).[11]

[10] *Interfax*, 21.12.1992, as reported by RFE/RL *Daily Report*, 23.12.1992. The EBRD indicates a decline in the volume of inter-republican trade of about 25-40% in 1992. Cf. EBRD, 1993, p. 22.

[11] Similarly, such a reduction has exerted a negative impact (although more difficult to quantify) on Soviet income too.

## 5. The current trade and payments systems

The NIRs trade and payments system during 1991 and 1992 has been characterized by three main features: i) the introduction and consolidation of restrictive measures – imposition of export licenses and other barriers against mutual trade – by individual republics in order to "preserve national resources"; ii) a deterioration of the interrepublic payments system, mainly due to the spreading of bilateralism; iii) the introduction of new currencies, coupons, ration cards and quasi-monetary instruments, in an attempt to insulate the economies against negative effects coming from neighbouring republics, especially the Russian Federation.

### *A. Trade*

In 1992 trade has been mostly carried out on the basis of intergovernmental agreements. Bilateral agreements included indicative lists of "strategic" commodities that could be traded up to a fixed volume limit. The volume limits were calculated so that trade would be balanced if transactions were conducted at world market prices. In reality trade occurred at negotiated prices. Surpluses and deficits which emerged were cleared using hard currency or roubles at negotiated exchange rates. (IMF, 1992, p. 8).

Trade protocols followed the pattern of dividing trade into three categories: (i) obligatory list trade; (ii) "indicative list" trade, and (iii) enterprise-to-enterprise trade. (Michalopoulos and Tarr, 1992, pp. 7-9).

The most important 100-150 products fell in the first category, for which an obligation of the state to fulfil the contract existed. Exports falling under this category were licensed and sold to specific enterprises in the importing country. According to the EBRD (1993, p. 20) trade volumes agreed for 1992 were on average 20% lower than the previous year's level. The "indicative list" trade was carried out on the basis of enterprise agreements defining sales conditions (including prices and credit terms). The products included in this category (1,000-1,500) were still subject to export licensing, in theory automatically provided, up to the amount specified in the protocol. Enterprise-to-enterprise trade was free of restraint, but apparently pertained only to products of minor importance.

As those clumsy procedures indicate, trade liberalization implicit in the regime change led paradoxically to an increase of administrative regulations of interrepublic trade. Moreover, the dissolution of the centralized system of planning and management made the actual fulfilment of those contracts rather uncertain. The agreements falling in the first category called for direct orders (state orders or *goszakazy* in the old Soviet terminology) to be fulfilled. However, enterprises are no longer interested in selling products

at a fixed price and with strict contractual obligations, especially under the almost hyper-inflationary conditions prevailing since 1992. Contrary to the old central planners, the new republic governments lack adequate administrative instruments to oblige firms to respect the agreements. During the first half of 1992 deliveries of many products fell short from meeting obligations included in inter-governmental agreements (Lupinovich and Malinka, 1992, p. 5).

Very often the response to unfulfilled deliveries has been the introduction of export restrictions. In 1992 all republics made widespread use of export licenses, partly also motivated by the existence of arbitrage based trade due to the lack of policy coordination, and particularly to the different timing and extent of price liberalization. This kind of restrictions added up to disruptions caused by supply problems and by political retaliation, while access to world markets appeared limited by the generalized shortage of hard currency.

### *B. Payments*

The intention to retain the rouble as official legal tender was announced in Alma-Ata at the founding meeting of the CIS on December 21, 1991. The Minsk Agreement of February 1992[12] reiterated the willingness of the member countries to use a "... common currency unit (the rouble) ... for the purpose of mutual settlements between the entrepreneurs, credit and other financial operations in the framework of the CIS" (Art. 2). At the beginning of May 1992 some of the central banks of the NIRs[13] established an Interbank Coordinating Council of the rouble zone. In the same occasion a resolution was passed to retain the rouble as the currency of the Commonwealth. Six republics (Armenia, Belarus, Kazakhstan, Kyrgyzstan, the Russian Federation, Uzbekistan) formally reiterated in September 1992 their will to maintain the rouble as only legal tender.

It became immediately clear, however, that the idea of maintaining a common mean of payments was little more than an illusion, given the lack of appropriate federal institutions and, even more importantly, of policy coordination among the CIS members.

First, the payments system resulted immediately grossly inadequate. Under the Soviet regime payments were cleared by *Gosbank* branches in the various part of the Union, through its network of cash settlement

[12] The English version has been published as Appendix II in IMF (1992), pp. 30-33.

[13] Lithuania, Azerbaijan and Turkmenistan attended, but did not sign the agreement. See *Business Eastern Europe*, 25.5.1992, p. 250.

centres. Following the disappearance of *Gosbank* at the end of 1991, payments settlements across republics became increasingly difficult. The IMF (1992, p. 9) reports that payments between enterprises in different republics could not be cleared directly between the cash settlement centres. Checks drawn on a bank in one republic could no longer be presented for payments in another part of the rouble zone. It followed that all non-cash interrepublic payments needed to be cleared through bilateral correspondent accounts at the central banks of the various republics, which, however, were introduced only at the beginning of 1992. In the second half of 1992 the extension of rights to finance imports to commercial banks (and through direct contacts among enterprises) complicated the matter further. Those cumbersome procedures strengthened the many shortcomings of the existing system and contributed to the disruption of interrepublic trade.

Second, the failure of the Russian stabilization program, and the irresponsible conduct of economic policy by many republican governments led to the *de facto* dissolution of the rouble zone and to the emergence of national currencies or quasi-currency. In particular three factors contributed to the collapse of the rouble zone: i) the shortage of roubles in most of the republics as a consequence of the lack of cooperation between the Russian government and the other republics; ii) the huge surplus that the Russian Federation accumulated *vis-à-vis* the other republics; iii) the existence of an incentive for the non-Russian republics to carry out a lax monetary and fiscal policy.

As we have seen, the predominant role of Russia as supplier of energy and raw materials makes it a structural creditor, with almost all the other republics as debtors. The cumulative Russian trade surplus amounted to R300 bn at the beginning of July 1992. Trade surpluses of this dimension represent a net drain of resources from Russia to the other NIRs, not coupled by a parallel building of assets.

The fact that at the beginning of 1992 the NIRs retained a common currency ruled out the possibility to use the exchange rate as an instrument of economic policy. However, membership of a currency area would have required a closer cooperation of economic policies between the member states, something that in the case of the NIRs remained only on paper. Indeed, not only the attempt to coordinate macroeconomic adjustment throughout the area has been extremely difficult, but even control of money supply has been impossible in practice. According to what has been identified by many authors as a classic "free rider" problem[14], in the absence of policy coordination, a state sharing a currency with other states

[14] See for instance: United Nations (1991), pp. 85-86; Havrylyshyn and Williamson (1991), pp. 30-31; Williamson (1992), p. 14.

benefits from running a budget deficit (financed in an inflationary way) and from allowing an almost uncontrollable expansion of credits. The inflationary costs spill over to the other states, while benefits accrue only to the republic that misbehaves.

Although the central banks of non-Russian republics did not have the right to print money (the Russian central bank had the monopoly of emission and all the printing presses were located in the territory of the Russian Federation), in response to the roubles shortage and the squeeze in money supply imposed by the stabilization program attempted in Russia at the beginning of 1992, central banks in the other republics started issuing rouble credits to local commercial banks and through them to companies. In July 1992, the Russian central bank decided to limit financing for republican imports to the amount of roubles it had explicitly credited in the correspondent accounts to the central banks of the importing countries. Monetary authorities of the other republics had to start distinguishing rouble credits "backed" by the Russian central bank in the correspondent accounts and those which were not. Each republic basically ended up having its own rouble for financing transactions, thus creating a multiplicity of "republic" roubles in the portfolio of the banks. A market developed where companies could buy the roubles they needed (i.e. Kazakh roubles for imports from Khazakhstan, Ukrainian roubles for imports from the Ukraine, etc.).[15] In practice separate republic currencies have been introduced in this way, although not backed by any gold or hard currency reserves, formally still identical to the old roubles, and floating against each other.

It has been observed (Nuti, 1992, pp. 2-3) that the former Soviet Union is at present neither a rouble zone, nor yet a set of countries with independent currencies. A rouble zone would require that all monetary units be exchanged at a 1:1 rate. As we have seen this is not the case even in the republics which are still using the rouble as a means of payments. The area is characterized by a mixture of national currencies, parallel circulation of roubles and other means of payments and rouble-only regimes.

## 6. The trend towards national currencies

The move towards the introduction of separate currencies strengthened in the second part of 1992. Four republics (the three Baltic states and the Ukraine) have already managed to issue their own national currencies – respectively: the Estonian *kroon*, the Latvian *lats*, the Lithuanian *talonas*

[15] See *The Economist* (1992).

coupon and the Ukrainian *karbovanets*, which have completely replaced the rouble in the domestic monetary system. The talonas and the karbovanets – which for a while circulated alongside the rouble – are still conceived by national authorities as an intermediate stage between the abandonment of the rouble zone and the introduction of their *true* symbol of monetary sovereignty (the Lithuanian *lit*, the Ukrainian *hrivna*).

Three other republics have at present a domestic payments system where both the roubles and national means of payment (circulating in parallel) are accepted as legal tender. Such alternative means of payment have been introduced in Azerbaijan (the *manat*, which should gradually replace the rouble), in Belarus (the *rubel*) and in Moldova. Even Belarus and Moldova, however, have declared their intention to issue proper national currencies (respectively: the *taler* and the *leu*). Moreover, Armenia (the *dram*), Georgia (the *marchvili* or the *maneti*) and Kazakhstan (the *tanga* or the *tumen*) have made open their will for a future introduction of separate currencies. Thus, we are left with only four republics, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan (where, however, part of the government deficit has been financed in 1992 with newly introduced coupons, see EBRD, 1993, p. 129), which in the short term will still keep the old Russian rouble as their own currency. Tajikistan is also planning for the future a currency change. Finally, it should be recalled that in more than one occasion even the government of the Russian Federation has mentioned the possibility of introducing a new currency as part of a renewed attempt to stabilize the economy.

The introduction of the kroon in Estonia is up to now the most relevant experience. Despite initial scepticism by the IMF (see Hansson and Sachs, 1992, p. 2) the introduction of the kroon (on June 20, 1992) has been carefully prepared and has probably set an important example for other currency reforms to come. The kroon has been made internally convertible and pegged to the deutschmark (after consultations with the Bundesbank) at a 8:1 ratio, a level which has not been abandoned thereafter. The exchange rate *vis-à-vis* the Russian rouble was initially set at a 10 roubles for 1 kroon (a level corresponding to the conversion rate for most part of cash holdings and bank accounts). Roubles were not initially freely exchangeable into kroons, though this was indirectly possible through the exchange in hard currencies, whereas more recently the Estonian authorities have further liberalised the currency market. Only a few days after the withdrawal of the roubles from circulation the kroon started appreciating towards the Russian currency (see Zaleski, 1992, p. 445). Since then, the rate with the rouble has been determined on the basis of the cross rate between the rouble and the DM on the one hand and the pegged exchange rate of the kroon *vis-à-vis* the DM on the other. The Estonian currency has

been backed by a stock of gold and foreign exchange reserves, and subsequently by an IMF loan related to an adjustment programme, which envisaged, among other things, a restrictive economic policy. The gold and foreign exchange fund has also been set up with the purpose of sustaining the currency's domestic management through a currency board. An agreement reached with the Central Bank of Russia – though at the last minute – aimed at avoiding excessive trade disruptions in the short run. The Estonian authorities agreed to surrender to the Russian government the roubles withdrawn from circulation.

The Latvian authorities have started the emission of the lats in early March 1993 with a rate of 1 lats to 200 Latvian roubles. The latter had been issued as a parallel currency in May 1992, and had become the only legal tender in July of the same year. The Latvian rouble had been initially exchanged at par with the Russian rouble, but from July to September 1992 it appreciated *vis-à-vis* the Russian currency – with which it is fully convertible, as well as the lats – by some 40%, also showing a remarkable stability towards the US dollar, probably helped by the heavy depreciation of the Russian rouble. Both the lats and the Latvian rouble will circulate alongside each other for several months.

Similarly, the Lithuanian talonas was first issued in August 1991 as a coupon, with an initial rate of exchange of 1:1 towards the rouble, already increased to 1:2 in January 1992. The talonas became the only accepted means of payment at the beginning of October 1992. The Lithuanian government plans to introduce the lit later this year. A remarkable feature of the talonas is its internal convertibility both for current and capital account purposes. As in the Latvian case, there is not a currency board at work.

Finally, the Ukrainian experience is similar to the Latvian and Lithuanian ones, with the main difference, however, that the karbovanets is the only new currency which is depreciating faster than the Russian rouble *vis-à-vis* hard currencies. After its debut as a coupon, the currency became the only legal tender in October 1992, though the Ukrainian authorities still plan to issue the hrivna in the coming months.

## 7. Advantages and risks in the transition to national currencies

Before their spreading up in the republics of the former USSR, opinions differed on the balance between advantages and risks of issuing separate currencies. On the one hand, the IMF stressed the dangers for inter-republican trade and for the entire stabilisation programme deriving from "the

ill-prepared introduction of new currencies'' (IMF, 1992, p. 12).[16] On the other hand it was argued that national currencies would have allowed a better management of monetary policies in a context of increasingly independent fiscal policies (Havrylyshyn and Williamson, 1991, pp. 38-39). To other observers (see for instance, Nordhaus, 1992, pp. 119-120), however, it was already clear that the difficulties in stabilising the rouble would have *inevitably* led to the rapid breaking up of the Soviet monetary space, i.e., of the rouble zone. In this respect, it may be useful to retain the distinction stressed by Williamson (1992, pp. 23-26) between a rouble zone and a rouble area. The former basically consists of a monetary space where the rouble is the only legal tender; the latter corresponds to an institutional setting where the rouble is the main regional means of payment and possibly also a reserve currency. On the basis of these definitions, there are few doubts – as maintained by Nuti (1992, p. 1) – that the rouble zone we were accustomed to know has definitively collapsed in the second half of 1992, while a rouble area – though of more limited dimensions and with different characteristics – could still re-surface as a consequence of the preponderant role of the Russian Federation in the region and especially in the event of stabilisation of the Russian currency.

Several motivations can be singled out in the move towards independent currencies. Political reasons are highly relevant: a national currency is one of the essential elements that completes the achievement of national independence and sovereignty. Both the relations between the new governments and the rest of the world and between the new states and their citizens are re-defined. The introduction of national currencies marks in the clearest way and, in a sense, makes irreversible, the separation of one country from another.[17] A new currency is one of the strongest symbols of political legitimacy for a new regime towards its citizens, a visible move from past arrangements and ties. These motivations are clearly present in many of the new independent republics. Their desire to disintegrate has been much

[16] For the reason that: ''the perceptions in republics of the separate currency issue – the IMF noted – do not generally embrace a comprehensive view of the monetary policy, exchange rate policy and institutional implications of introducing a separate currency'', 1992, p. 12.

[17] The reverse is also true: the move from national currencies to a single money weakens the distinction between different nations, as the reluctance by many Western European countries to abandon ''their'' money for the ECU or some other supranational monetary symbol has recently shown.

stronger than any other consideration stressing the economic advantages of sharing a common currency with a number of neighbours and partners.

In the former Soviet republics the introduction of national currencies has been a way to overcome the problems created by the shortage of roubles. Indeed, the need to dispose of cash instruments readily available have been a strong, driving force behind the haste to resort to additional means of payments other than the rouble.

However, the adoption of a national money in the NIRs rests also on sound economic grounds. First and foremost, a domestic currency managed by an independent central bank allows a more efficient control on money and credit aggregates than that exercised in the rouble zone by the Russian central bank. Moreover, given the absence – or, at best, the rudimentary functioning – of monetary and financial markets, the management of monetary policy extends to the design of fiscal policy, the financing of the budget deficit being virtually under the responsibility of monetary authorities. With an independent currency, stabilization measures can be carried out more speedily and efficiently given the possibility of a tight check on domestic money supply.[18] Adjustment policies will be perceived as more credible by the population. This means that more politically legitimated governments and central banks will have a credit to spend when implementing tough stabilization plans.

Even in the long term the national currency arrangement seems superior to the maintenance of a rouble zone. The distribution of roubles by the Russian Central Bank to the NIRs according to parameters such as national income or regional trade shares, typical of the rouble zone, is an inefficient solution (except, as we shall see, in the short-term). Rules of this kind are too mechanic to take into account the specific needs of each republics, that is, of systems which will no doubt *diverge*, to a certain extent, from each other. In a period of deep institutional changes and in an unstable macroeconomic situation, a centralized monetary policy would require very strict provisions concerning credit creation, particularly in order to fulfil the anti-inflationary stance of monetary policy. Moreover, a centralized monetary policy could be carried out only if the Russian government is willing and capable to coordinate monetary and credit policies for the entire

[18] According to Hernandez-Cata, (1992, p. 63) "by controlling the rate of expansion of its own money supply, the country's authorities could achieve a lower rate of inflation than that prevailing in Russia and other parts of the rouble area". He also points out, however, "that given the size of the Russian economy, no former republic will be able to insulate itself from real developments in the rouble area".

area and that the smaller republics are ready to accept Russian leadership on economic policy.

Second, the existence of a national currency allows much higher flexibility in the conduct of economic policy. The introduction of an independent currency – coupled with structural reforms of the banking sector – would be particularly relevant as an institutional channel for implementing central banks' decisions. The autonomous management of the exchange rate helps to increase the openness and the competitiveness of the economy *independently* of the decisions taken by other NIRs. In a situation of increased trade liberalization the introduction of forms of convertibility would also allow the NIRs to import a meaningful structure of relative prices.

Furthermore, an independent currency permits the conduct of discretionary trade policies: a devaluation, for instance, could avoid the strengthening of a protectionist trend, a circumstance which, however, seems especially relevant only in the long-term, i.e. when exchange rate adjustments will depend more on real competitiveness and not exclusively on the different degrees of (hyper)inflation among NIRs.

Finally, a state beginning to issue of a national currency enjoys the economic advantages of *seigniorage*. On the contrary, in an economic area with different fiscal policies and with a single source of money creation, the advantages of issuing a currency would be reaped off only by the country in control of the currency emission. (Fischer, 1982).

The move from an integrated monetary space to an area of independent currencies presents also many risks and possible negative implications. Some of the potential costs are strictly linked to the appearance itself of a multiplicity of currencies. The spreading of national means of payments in an area formerly strongly integrated increases transaction costs and adds up to the impediments to the free circulation of goods, services and capital deriving from the disintegration process.

Other costs and risks are related to the way in which a new currency is introduced, and particularly to the timing such a move is carried out in the sequence of structural reforms. The decision to issue republican currencies has been so far taken in heavily deteriorated macroeconomic environments, characterized, among other things, by a dramatic output fall and almost hyperinflationary conditions. Under those circumstances the confidence of households and enterprises in the new currency can easily be undermined.

It can be argued that, as in several historical experiences, the introduction of a new currency could be a crucial component of an overall stabilization plan. This is only true, however, if the monetary reform is paralleled by a set of policy measures which properly address the causes of the instability. Vice versa, in the case of the former Soviet republics not only monetary

and credit policies have been too lax, but also too little attention has been paid to the structural causes of inflation.

Three main causes of price instability can be observed in the NIRs. First, price liberalization does not limit its inflationary effects – as implied by many advocates of shock therapy – to the first months of its implementation. On the contrary, the recomposition of the structure of relative prices – which is, after all the final goal of a price reform – is inevitably bound to be a long-term process, given its tight link with reforms such as privatization and demonopolization. Such instability – coupled in almost all experiences with a clumsy and naive implementation of price liberalization – reinforces households' and firms' inflationary expectations. Price increases resulting from the process of reform could be purely inflationary, with the risk of the explosion of hyperinflation. However, it should be reminded that with price liberalization economic agents finally learn to deal with a less un-realistic, albeit unstable, price structure.

Second, fiscal imbalances deriving from the reduced tax base of the state – in turn due to negative real growth and privatization – are generally financed in an inflationary way, as convincingly argued by McKinnon (1992, pp. 112-16).

Finally, once fully carried out, the liberalization of energy prices, especially if delayed, will give further impetus to price increases. Simple checking of credit and money supply is not enough to reduce price instability and to put an end to inflationary expectations. The introduction of a new currency in those circumstances is unavoidably bound to fail.

## 8. New trade and payments arrangements

The future evolution of trade among the NIRs will be affected by the type of exchange rate arrangements which will prevail.

Three main scenarios and related policy implications can be distinguished. The first assumes *mutual inconvertibility* and thus does not contemplate a complete move towards foreign currency liberalization. The second envisages the introduction of a new domestic currency, convertible *vis-à-vis* all the others. The third scenario analyses the possibility of the adoption of internal convertibility in the non-Russian republics, though limited to transactions involving the Russian rouble – that is implies the recreation, on completely new basis, of a rouble *area*.[19]

[19] It should be stressed here that this exercise will be carried out under the assumption that all NIRs (or at least the majority of them) do not create substantial impediments to the free exchange of goods and services. We can think of a customs union, or, more

A floating exchange rate system is already emerging at regional level given the high rates of inflation presently characterizing all former Soviet republics. A regional exchange rate system based on fixed rates would not have in the present conditions any chance to last more than a few weeks, since the different rates of inflation would exert a very strong pressure for exchange rate adjustment.

### *A. Regional inconvertibility*

In the first scenario the decision of postponing some form of current account convertibility would have disastrous consequences on interrepublic trade. Trade will be based on barter contracts and bilateral agreements would prevail. The exchange rate would still be administratively determined, but would give signals concerning the competitiveness of the economy to the government (though black market rates could be more realistic).

As already suggested by several authors, an efficient solution to overcome some of the problems raised by regional inconvertibility would be the setting up of an agreement among the NIRs along the lines of the 1950s European Payments Union (EPU).[20] The functioning of a Republican Payments Union (RPU) has already been described with plenty of details: the two basic features of a RPU are a multilateral clearing system and the granting of mutual credit among the participants.

The need to devise multilateral solutions has already inspired the idea to create the CIS Interstate Bank among ten of the fifteen NIRs (excluded from the agreement signed last October are the three Baltic States, the Ukraine and Georgia). The draft Charter of the new bank (approved last December) clarifies the aims of the new institution. In particular, the bank should provide "the organization and implementation of multilateral clearing services between national (central) banks of interstate trade-related and other payments and their final settlement" (Article II.1) and "short-term credit extended among members of the Interstate Bank to facilitate settlements" (Article II.6). These features overcome the problems both of inconvertibility – by assuring the *transferability* of currencies – and, though

simply and realistically, to low levels of tariffs and trade barriers. Another strong assumption will be that all non-Russian republics will take similar decisions.

[20] Cf. Bofinger (1991), Dornbusch (1991), Gros (1991a); pros and cons of the application of the EPU mechanisms to Central and Eastern European countries are discussed in Bofinger (1990), Brabant (1991), Daviddi and Espa (1989) and (1992a), Kenen (1990).

partially, of the financing of the deficit *vis-à-vis* the Russian Federation. The latter, however, is quite a serious issue since it is hard to expect that Russia will indefinitely finance trade imbalances with the other republics given its status of structural creditor. The following months will tell us if the new institution will effectively take off or if it will be another purely formal and thus aborted attempt to promote regional cooperation.

As in the case of the proposals for setting up a Central-East European Payments Union, where similar problems arose, foreign intervention would be crucial. A payments union could only work if Western multilateral institutions provide the starting capital of the institution and they are ready to re-finance, if necessary, the deficit positions resulting after the clearing procedures have been carried out. Moreover, the granting of aid, soft loans or other concessional financing should be conditioned to the engagement, by the Russian government, of an advance of rouble credits to the NIRs. The advantages of this mechanism (inspired by the EPU's conditional aid) would extend from non-Russian industries to the Russian government and exporters. Western aid would not be wasted and would serve a highly crucial purpose: sustain regional trade in the transition period and before convertibility is eventually introduced, without sacrificing those firms whose profitability could be preserved to the hardships of the transition and to the breaking up of the payments system.

### *B. Regional convertibility*

This scenario envisages the introduction of new currencies, convertible at regional level. Usually, a basic distinction between *internal* and *external* convertibility is made in the literature. In the first regime, residents of each NIRs have the possibility of freely acquiring the amounts of republican currencies they deem necessary for their current account transactions.[21] The second one regards the possibility of allowing the free circulation of the new currencies outside the borders of the issuing republics.[22] Obviously, the move to regional external convertibility is sustainable only if it is based on the mutual acceptance of all republican currencies as regional means of payments. It should be reminded here that all Central-Eastern countries which have implemented significant currency

[21] This also means that every NIRs' central bank must hold fourteen different republican currencies in its official reserves.

[22] This regime of regional *external* convertibility would then make, for instance, the Ukrainian hrivnia accepted by a Byelorussian exporter who would then get the equivalent amount of his rubels from the domestic banking system.

liberalizations have adopted the *internal* regime, thereby excluding the possibility of transactions involving the domestic currency outside its country of emission.

In both regimes importers and exporters would freely get the amounts of republican currencies they need for their current account transactions. However, regimes of internal and external convertibility practically coincide if countries belonging to a monetary area are to make their currency available to the remaining partners. As a matter of fact, the introduction of internal convertibility in a former Soviet republic means that the new currencies, in order to be exchanged in any other state, have to be *externally* convertible. In absence of capital flows, for instance, there is no way a Ukrainian importer could get Belarus rubels, unless the latter is allowed to circulate outside its country of emission.

The negative consequences on interrepublic commercial flows are generally supposed to be limited and in any case less severe than in the previous case. Even with the adoption of this regime, trade would undoubtedly contract because of rising transaction costs, of uncertainties surrounding the evolution of neighbour regions which have now become foreign countries, of exchange rate instability and of the ensuing possibility to use protectionist instruments. Exchange rates will depend on the difference in inflation rates – in turn linked, as we have seen, to the different timing of stabilizations and price liberalizations – to emerging macroeconomic fundamentals, and on the matrix of regional trade.

### *C. The new rouble area*

In the two scenarios sketched above, the prevalence of trade flows towards the Russian Federation implies that the Russian rouble, if stabilized, could become a regional means of payment. Unless real domestic demand in the republics is widely slashed, the problem of financing the existing structural deficits *vis-à-vis* the Russian Federation would play a central role. The fact that the Russian Federation will not easily accept to be paid for its exports with republican currencies reinforces the likelihood of a wider role of the rouble.

There is thereby a real possibility that internal convertibility is introduced within non-Russian NIRs *exclusively* for the purpose of acquiring Russian roubles. This would correspond to the (re)creation of a rouble area. In addition to that, and especially in case of credible antinflationary plans by the Russian government, the value of the rouble would be determined in a wider market (with strong regional currency demand). The exchange rate of the rouble would then no longer depend exclusively on its evolution in the thin market for Western currencies.

The possibility of setting up a rouble area on new basis depends above all on the willingness of the Russian authorities to allow a free circulation of roubles and the opening of rouble-denominated banking accounts *outside* its borders. The currency regime prevailing in the Russian Federation would then be a mix of limited internal convertibility towards hard currencies and external convertibility *vis-à-vis* the other republican currencies. Moreover, the Russian authorities would have to dictate the stance of macroeconomic policy to the other members of the rouble area.

A possible advantage of a Russian-led monetary area – an event, however, at the moment far from reality – lies in the fact that the rouble could play, in case of its stabilization, the role of the strong currency among the NIRs' currencies, and thus help the other republics to contain the extent of monetary disturbances. Vice versa, as already discussed in section 5, the persistence of monetary disequilibria in the Russian Federation and the consequent heavy depreciation of the rouble towards Western currencies could undermine the attempt by non-Russian NIRs to stabilize their currencies.[23]

In principle, the recreation of a rouble area would highly simplify the regional payments system, though there would still be the issue of how and to what extent to finance the deficits *vis-à-vis* Russia. In the initial phase. deficits towards Russia could be financed – as part of more general negotiations – with part of the roubles withdrawn from circulation when implementing the introduction of the new currency (the percentage suggested by Williamson, 1992, pp. 25-26, is 10%, but it could be higher, considering also the advantages for Russian exporting industries).

### *D. Convertibility vis-à-vis Western currencies*

The external regime of the NIRs has to be defined also with respect to Western currencies. Contrary to the experience of both the Estonian kroon and the Latvian lats, immediately declared freely convertible *vis-à-vis* Western currencies, a prudential attitude should prevail when planning to open up republican economies. With the exception of the Russian Federation, current account deficits characterize the relations between the NIRs and the West and hard currency shortage is still the rule in the region. Moreover, unless domestic inflation is brought to a halt, there is little chance to defend the exchange rate levels chosen as peg with hard currencies. It should also be stressed here that – as it has happened in

[23] Although, the heavy undervaluation of the Russian rouble might explain the stability of the exchange rate of many republics'currencies vis-à-vis Western currencies, despite the presence of extremely high inflation rates.

Russia – the thinness of foreign currency markets could abnormally amplify the depreciation of the currency, with significant repercussions on the determination of cross-rates.[24] The spreading of distorted signals from the exchange rate to the domestic economy would nullify one of the main motivations behind the introduction of hard currency internal convertibility, i.e., the need to import market signals from world prices.

Western financial assistance could help in setting up a convertibility regime, but it would not be enough if the rise in prices is not significantly slowed down and if the risks of capital flights are not minimized by more stable macroeconomic conditions.[25]

### *E. Policy implications*

There are a number of policy implications which need to be stressed at this point. In order to be a stabilizing factor, and not a channel for the amplification of imbalances, the introduction of a new currency must satisfy some important conditions. The presence of a central bank is *the* first fundamental element, better if the degree of autonomy from the government is very high.[26] Second, a rigorous control on money and credit creation seems of the utmost relevance. Until the implementation of a government bond market gives more flexibility to monetary policy and in view of the fragile conditions of the current account balance there are few doubts that monetary (and fiscal) policies should be of a restrictive character. Third, the CIS republics, Georgia and possibly also the Baltic states should proceed to some form of coordination of their most important reforms, in order to decrease the degree of overall imbalances. The West has all the financial weapons – especially conditional lending, not necessarily of the IMF-type – to convince the countries concerned of this necessity, although we are perfectly aware that the rouble zone collapsed exactly for the NIRs unwillingness to coordinate their economic policies. However, experience tells

[24] On the consequences of the thinness characterizing the Russian currency markets, see Daviddi, Espa and Uvalic (1992).

[25] In the Russian Federation capital flights were estimated in 1992 at some $13-15 bn. The presence of uncertainty and the increase of capital flights has also prevented the granting of the G24 $6 bn rouble stabilization fund. According to M. Camdessus, if the fund had been granted, "a few days afterwards the $6 bn would have been in an account in Paris, Geneva, London or Zurich". *IMF Survey*, February 22, 1993, pp. 51-52.

[26] It should be remembered, however, that under specific circumstances too much independence could be harmful, as the recent Russian experience of a reforming government and of a conservative central bank suggests.

us that coordination is no panacea at all if fundamentals between countries are divergent or if speculative forces are able to dominate the market.

As repeatedly stressed in the previous pages the need to stabilize the rouble is a necessary condition for the success of any kind of agreement among the NIRs. Therefore, a more serious attempt should be made to stabilize it. Assuming that the Russian currency is under firm control, and if some form of coordination is achieved, an EMS-type of exchange rate mechanism should be devised; oscillation bands would be wide and realignments possible. Finally, in case of regional inconvertibility a payments – or at least a clearing – union should be devised, along the lines already indicated.

We are convinced, however, than those republics which have not yet issued their own currency should better wait and postpone their plans of monetary sovereignty. As argued elsewhere (Daviddi and Espa, 1992b), it seems more convenient to absorb the present inflationary tensions – and the ones likely to come from further increase of energy prices – with the old currency. Otherwise, the new currency could be rapidly wiped out by runaway inflation. This reasoning could also apply to republics which are in the transitory stages of their currency reforms.

The new currency, as already mentioned, can and indeed should be used – like in several monetary reforms of the past – as an instrument in the process of economic adjustment. Together with other stabilization measures, the introduction of a new currency would give households and entrepreneurs a clear sign of change.

## 9. Conclusions

In this paper we have maintained that the move towards national currencies in many independent republics of the former Soviet Union – though politically unavoidable and economically efficient in the long term – is having disruptive effects on interrepublic trade. In the short term, heavy losses of income and employment derive from the neglect of the high level of economic interdependence among former Soviet republics, from the dissolution of the Union and the disappearance of its re-distributive mechanisms. Costs are increased by the adoption of adjustment programs in most republics and by the parallel undertaking of structural reforms.

In this context, the introduction of national currencies can be undermined by conditions of structural inflation. For this reason we suggested that decisions concerning the introduction of new currencies should be implemented only after price inflation has begun to slow down. Only in this

respect the birth of new legal tenders in the republics could be an essential component of the stabilization program.

If other considerations prevail and, as in the current experience in the former USSR, national currencies are introduced, then the presence of mutual convertibility among them could allow to overcome the most negative consequences on trade and production deriving from their adoption. However, a process of too fast opening up of the economy could be costly and unsustainable, and require the adoption of strongly deflationary economic policies.

An intermediate regime which could help to sustain the level of income and employment would be based on the use of the Russian rouble as a regional currency. Such a move, however, implies the exit of the Russian economy from its present almost hyperinflationary conditions. This is also why Western financial efforts should be, *first of all*, directed to stabilize the rouble.

If the republics fail to co-operate or the rouble is not stabilized, future developments may be rather worrying. The effects of mutual inconvertibility on interrepublic trade could be disastrous and only some form of payments agreement could reduce the magnitude of output and income contraction. Although other issues would still remain on top of the agenda of reforms, above all the coordination of stabilization plans and structural reforms, a payment union would give some breathing space, necessary for the implementation of longer-term undertakings such as privatization, industrial restructuring, or trade re-orientation.

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| **Table 1.** Total and inter-republican trade [1] as percentage of GNP in 1990 | | | |
|---|---|---|---|
| Republic | Foreign trade | | |
| | Total | Inter-republican | Share of inter-republican on total trade |
| Russian Federation | 18.3 | 11.1 | 60.7 |
| Ukraine | 29.0 | 23.8 | 82.1 |
| Belarus | 47.3 | 41.0 | 86.7 |
| Uzbekistan | 28.5 | 25.5 | 89.5 |
| Kazakhstan | 23.5 | 20.8 | 88.5 |
| Georgia | 28.9 | 24.8 | 85.8 |
| Azerbaijan | 33.9 | 29.8 | 87.9 |
| Lithuania | 45.5 | 40.9 | 89.9 |
| Moldova | 33.0 | 28.9 | 87.6 |
| Latvia | 41.4 | 36.7 | 88.6 |
| Kyrgyzstan | 32.2 | 27.7 | 85.8 |
| Tajikistan | 35.9 | 31.0 | 86.4 |
| Armenia | 28.4 | 25.6 | 90.1 |
| Turkmenistan | 35.6 | 33.0 | 92.7 |
| Estonia | 32.9 | 30.2 | 91.8 |
| Average | 33.0 | 28.7 | 86.3 |
| re: EC average | 23.1 | 13.7 | 59.2 |
| [1] Trade is measured by the average of exports and imports as percentage of GNP | | | |
| [2] Inter-republican trade as percentage of total trade | | | |
| Source: Authors' calculations based on *Narodnoe Khozyaistvo* for the CIS states and Eurostat *Comext Databank* for the EC. | | | |

| **Table 2.** Export to Russia as percentage of Net Material Product in 1990 | | | |
|---|---|---|---|
| Republic | Export | Net Material Product | Export/NMP |
| Ukraine | 25248.6 | 117992.4 | 21.4 |
| Belarus | 9938.3 | 29509.7 | 33.7 |
| Uzbekistan | 4840.2 | 23603.0 | 20.5 |
| Kazakhstan | 4276.3 | 33361.6 | 12.8 |
| Georgia | 3557.9 | 10865.7 | 32.7 |
| Azerbaijan | 3705.2 | 10712.3 | 34.6 |
| Lithuania | 2707.4 | 9999.9 | 27.1 |
| Moldova | 3488.8 | 9442.7 | 36.9 |
| Latvia | 2512.5 | 8849.3 | 28.4 |
| Kyrgyzstan | 897.1 | 6026.5 | 14.9 |
| Tajikistan | 1167.6 | 5489.8 | 21.3 |
| Armenia | 1851.2 | 6976.6 | 26.5 |
| Turkmenistan | 1276.4 | 5321.4 | 24.0 |
| Estonia | 1816.2 | 5469.1 | 33.2 |
| Total | 67283.7 | 283620.0 | 23.7 |
| Source: Authors' calculations based on *Narodnoe Khozyaistvo*. | | | |

| **Table 3.** Export to the FRG as percentage of EC members GNP in 1989 (ECU bn) | | | |
|---|---|---|---|
| | Export | GNP | Percentage |
| Belgium - Luxembourg | 18.9 | 145.4 | 13.0 |
| Denmark | 4.6 | 95.1 | 4.9 |
| Greece | 1.6 | 49.2 | 3.2 |
| Spain | 4.9 | 345.2 | 1.4 |
| France | 29.3 | 870.3 | 3.4 |
| Ireland | 2.1 | 30.8 | 6.9 |
| Italy | 21.7 | 786.5 | 2.8 |
| Netherlands | 29.3 | 203.2 | 14.4 |
| Portugal | 1.9 | 41.1 | 4.5 |
| United Kingdom | 16.4 | 760.3 | 2.2 |
| Total | 130.6 | 3327.1 | 3.9 |
| Source: Authors' calculations based on EUROSTAT data | | | |

**Table 4.** Ranking of main trade partners by Republic in 1987 (in percent)

| *Russia* | *Ukraine* | *Belarus* | *Uzbekistan* | *Kazakhstan* | *Georgia* | *Azerbaijan* | *Lithuania* | *Moldova* | *Latvia* | *Kyrgyzstan* | *Tajikistan* | *Armenia* | *Turkmenistan* | *Estonia* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 13.8 | 52.1 | 75.9 | 52.3 | 52.0 | 56.9 | 55.4 | 80.1 | 75.5 | 69.1 | 45.7 | 49.2 | 68.2 | 52.0 | 84.8 |
| Ukraine | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia | Russia |
| 5.1 | 5.6 | 22.0 | 11.4 | 8.8 | 15.4 | 15.0 | 16.5 | 33.3 | 18.3 | 11.3 | 13.9 | 18.9 | 18.2 | 19.6 |
| Belarus | Belarus | Ukraine | Ukraine | Ukraine | Ukraine | Ukraine | Ukraine | Ukraine | Ukraine | Ukraine | Uzbek. | Ukraine | Uzbek. | Ukraine |
| 3.7 | 2.5 | 4.3 | 8.4 | 6.4 | 4.9 | 1.9 | 12.3 | 9.0 | 11.4 | 10.4 | 13.22 | 7.5 | 13.6 | 9.3 |
| Kazakh. | Moldova | Kazakh. | Kazakh. | Uzbek. | Belarus | Kazakh. | Belarus | Belarus | Belarus | Kazakh. | Ukraine | Azerbaijan | Ukraine | Latvia |
| 2.8 | 2.3 | 4.1 | 4.1 | 4.1 | 4.5 | 4.9 | 8.7 | 3.0 | 1.1 | 5.4 | 1.0 | 7.3 | 4.0 | 8.4 |
| Uzbek. | Kazakh. | Lithuania | Turkmen. | Belarus | Azerbaijan | Belarus | Latvia | Latvia | Lithuania | Belarus | Kazakh. | Belarus | Kazakh. | Belarus |
| 1.8 | 2.3 | 3.0 | 3.5 | 2.0 | 4.4 | 4.3 | 2.8 | 3.0 | 5.6 | 3.4 | 4.4 | 4.1 | 3.8 | 4.4 |
| Lithuania | Uzbek. | Latvia | Kyrgyzstan | Azerbaijan | Kazakh. | Georgia | Kazakh. | Kazakh. | Estonia | Tajikistan | Belarus | Uzbek. | Azerbaijan | Lithuania |
| 1.6 | 1.6 | 1.8 | 3.5 | 1.9 | 3.1 | 39.4 | 2.7 | 2.5 | 4.3 | 2.6 | 3.5 | 4.1 | 3.1 | 3.9 |
| Azerbaijan | Azerbaijan | Uzbek. | Belarus | Kyrgyzstan | Uzbek. | Armenia | Uzbek. | Lithuania | Kazakh. | Turkmen. | Kyrgyzstan | Georgia | Tajikistan | Kazakh. |

Source: Authors' calculations based on *Goskomstat* data

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